

Administrator Steven C. Preston
U.S. Small Business Administration
U.S. Senate Small Business and Entrepreneurship Committee
Holding SBA Accountable: Women's Contracting and Lender Oversight
January 30, 2008

Thank you for inviting me to testify today on behalf of the U.S. Small Business Administration (SBA) regarding the Federal Government efforts in contracting with women-owned small businesses as well as the SBA's activities in small business lending oversight.

I would like to address the contracting issue first. The proposed rule that will implement the Women-Owned Small Business Federal Contracting Procedures set-forth in P.L. 106-554 has been published. Public comments on the proposed rule are due by February 25. SBA has been, and remains, committed to implementing the statutorily-authorized set-aside for women-owned small businesses and intends to do so in a constitutionally valid manner, while at the same time meeting the specific directives provided in the legislation.

History

In 1994, through the Federal Acquisition Streamlining Act (FASA), Congress established a statutory goal of not less than 5 percent of the total value of all Federal Government prime contract and subcontract awards for each fiscal year going to women-owned small businesses (WOSBs). The Federal Government has made consistent progress toward reaching the prime goal. Federal prime contract dollars going to WOSBs increased from \$2.4 billion in FY 1994 to \$11.6 billion in FY 2006 (3.4 percent of contracting dollars). Subcontracting dollars have increased from \$3.6 billion in FY 2000 to over \$10.1 billion in FY 2006, representing 6 percent of subcontracting dollars. SBA's Office of Government Contracting and Business Development (GCBD) is working closely with Offices of Small Disadvantaged Business Utilization (OSDBUs) in the major Federal procuring agencies to promote the use of WOSBs and encourage the Agencies to reach the 5 percent goal.

In December of 2000, Congress passed legislation creating the framework for Women-Owned Small Business Federal Contracting Procedures.

Consistent with the requirement in the legislation for SBA to determine the underrepresentation of WOSBs in the Federal contracting marketplace, SBA itself conducted a study to establish the necessary findings. Once completed, an independent panel of experts at the National Academy of Sciences (NAS) reviewed the study to assess the sufficiency and validity of SBA's methodology. Ultimately, NAS concluded that the original SBA study was flawed. NAS recommended a methodology for performing a study that would more effectively withstand legal and statistical scrutiny.

RAND Report

On February 21, 2006, SBA awarded a contract to the RAND Corporation and it commenced work on a study, in accordance with the methodology recommended by NAS, to determine those industries in which WOSBs are underrepresented and substantially underrepresented in Federal procurement. The RAND study was completed in April 2007 and since then SBA has been engaged in a government-wide effort to complete this proposed rule in a manner that will satisfy both statutory and constitutional requirements.

Following SBA guidelines which were approved by NAS, RAND defined underrepresentation as a disparity ratio of 0.80 or less, while substantial underrepresentation was defined as a ratio of 0.50 or less. NAS recommended applying this analysis to data found in the 2004 Central Contractor Registration (CCR) and the 2005 Federal Procurement Data System / Next Generation (FPDS-NG) cross-referenced with the North American Industry Classification System (NAICS) industry codes at the four-digit level based on either contract dollar amounts or the number of contracts. With the disparity thresholds of 0.50 and 0.80 established, RAND examined 28 different approaches that looked at a wide range of data collected by the Federal Government including data in the CCR, the Federal Procurement Data System/Next Generation (FPDS/NG) and the 2002 Survey of Business Owners (SBO) from the five-year economic Census. Relying on the guidance offered by NAS and the actual results of parsing the data, RAND then began to zero-in on those methods that most accurately measured underrepresentation and substantial underrepresentation. After very careful analysis of the four remaining approaches, SBA adopted the approach that best captured the most appropriate measures. NAS guidance is clear that SBA should use the NAICS code level that most clearly disaggregates between industries performing similar activities. SBA determined that the four digit NAICS code level best meets this criteria. The methodology utilizing the dollar amount was also found to be the most justifiable measure of WOSB contract representation because:

- Most importantly, the very goal (5 percent WOSB participation based on “total value” of contract awards) the statute was intended to support is based on contracting dollars, and thus using contract dollars as the primary measure of representation is most consistent with the statutory framework;
- In addition, Congress appropriates federal funding in dollars;
- The Federal budget is allocated in dollars;
- All government contracts are awarded in dollars;
- The accounting and auditing processes focus on how dollars are spent; and
- Contract numbers do not allow for an accurate accounting of the financial benefits of business development that occur when small businesses receive Federal contracts.

Based on the determined methodology, four industries were identified where WOSBs were either underrepresented or substantially underrepresented:

- National Security and International Affairs;
- Coating, Engraving, Heat Treating, and Allied Activities;

- Household and Institutional Furniture and Kitchen Cabinet Manufacturing; and
- Other Motor Vehicle Dealers.

Constitutional Concerns

While the role of SBA is to aid, counsel and assist small businesses, it is not the role of the Agency to advise on questions of constitutional law. Therefore, SBA worked closely with the Department of Justice in drafting a proposed rule that is cognizant of the exacting constitutional requirements that apply in implementing a gender-specific set-aside. According to Supreme Court precedent, the Equal Protection Clause requires “skeptical scrutiny of official action denying rights or opportunities based on sex,” and any gender-based preference program must be supported by an “exceedingly persuasive justification.” *United States v. Virginia*, 518 U.S. 515, 533 (1996). As applied to the Federal Government, the constitutional standards prohibit Federal agencies from discriminating on the basis of gender in awarding of Federal contracts unless the preference furthers important governmental objectives and the means employed are substantially related to the achievement of those objectives. *Id.* at 533.

The Department of Justice advised that in order to conform to these constitutional standards, simply finding underrepresentation generally will not suffice to sustain the set aside of contracts for WOSBs. Consequently, the soundest means of assuring constitutional compliance is for the procuring agency to determine that setting aside those contracts solely for WOSBs is substantially related to remedying gender discrimination in the relevant industry or contracting sector.

Summary of the Regulation

The proposed rule will assist WOSBs in procuring contracting opportunities with the Federal Government by providing procedures for certifying a business as an eligible WOSB, protesting eligibility determinations and awards, as well as providing a framework for agencies to make the determination that WOSB underrepresentation is related to gender discrimination. In addition, the rule sets forth when contractors can restrict competition to WOSBs.

Women’s Procurement Goal

SBA's goal is not only to develop regulations implementing these procedures, but to help WOSBs so they can compete both in the private market place and for Federal contracts.

In analyzing the data found in the RAND study, we recognized that the real issue is that there are not enough WOSBs registered in CCR. As a result, we are analyzing what we have done in the past and what additional steps we can take to increase the number of WOSBs able to pursue Federal contracts.

In addition, SBA has been working with its resource partners to educate women entrepreneurs not only on how to contract with the Federal Government, but on how to establish and grow their businesses. Currently, SBA provides business counseling and events including business matchmaking and networking opportunities through SBA field offices located around the country and through SBA resource partners, including Small Business Development Centers (SBDCs), SCORE and Women Business Centers (WBCs), that counsel prospective business owners on elements necessary to start a business.

SBA is taking a forward-looking approach. First, our programs are tasked with growing the universe of WOSBs and encouraging these businesses to register with the CCR, thus making these businesses eligible to contract with the Federal Government. Second, the role of SBA is to help those businesses become ready, willing and able to undertake and build a successful track record working with the Federal Government.

These initiatives will help WOSBs to achieve the congressionally-established goal. We must remember that there is no single magical approach that will expand the participation of women-owned small businesses in Federal procurement; rather a combination of initiatives that take into account the individual needs of businesses is the best approach to provide opportunities for women small business owners to do business with the Federal Government.

The WOSB rule submitted by the SBA represents careful analysis which culminated in a proposed rule utilizing the most justifiable measures and methodology. SBA fully supports WOSBs and will take all necessary steps to implement this rule.

Lender Oversight

On November 13, 2007, I appeared before the Senate Small Business and Entrepreneurship Committee to discuss SBA's ongoing efforts in managing credit risk, monitoring lender performance and enforcing lending program requirements. I detailed to the Committee SBA's progress in putting measures in place to manage risk in loan programs while increasing access to business loans. SBA continues to consider ways to improve its oversight ability while maintaining an environment where lenders want to continue their participation in the program.

The Office of Inspector General (OIG) has made multiple recommendations to improve lender oversight. Many of those recommendations are directed to preventing fraud or excessively risky lending. As the OIG has noted, however, it is not always possible to prevent fraud or risky lending. The fact that it took OIG and the U.S. Secret Service agents over five years before arrests could be made against the individuals involved in the Business Loan Express (BLX) loan fraud scheme demonstrates that point. The OIG reports and recommendations have been valuable in pointing out some areas where SBA could improve oversight and SBA has taken concrete steps to make improvements that address many of the recommendations. While SBA continues to make programmatic

improvements including progress on the IG's recommendations, any changes must be in accordance with applicable law and must consider the needs of the small business community. Such changes also must allow for the flexibility required in our oversight role. We continue to press for improvements and to work with the IG.

SBA continually updates its lender oversight procedures to adapt to an ever-changing business environment and Congressionally mandated program responsibilities. There are a number of steps we are taking right now that we expect will improve our oversight function:

- We have implemented a process for replacing our loan accounting system. This new system will contain more information on loans and lenders, that can be leveraged for oversight purposes. Recently we re-initiated the procurement process. This will facilitate a faster implementation of the system replacement.
- We issued proposed regulations that would clarify the lender oversight process and add a level of clarity to the Agency's oversight activities.
- We have implemented a training and staffing reengineering initiative at our Herndon and Sacramento processing centers that will improve their capacity and responsiveness.
- SBA is revamping the SBAExpress and Community Express procedures and their purchase and liquidation processes.

Mr. Chairman, Ranking Member Snowe, and Committee members, we are making progress in lender oversight while increasing access to small business loans in underserved communities. A recent study by the Urban Institute, a nonpartisan economic and social policy research organization, found that SBA backed loans are more effective than conventional loans in reaching minorities, women and start-ups and that SBA loans are a useful financing tool for creditworthy small businesses that do not meet conventional underwriting standards. SBA is pleased to have confirmation that we are providing credit solutions to this underserved population and has rolled out several initiatives to further increase participation in our lending programs so creditworthy entrepreneurs have access to capital. It is this access to capital that is so vital to our economy. We at SBA will continue to make progress in both reaching America's small businesses while managing program risk.

Thank you for the opportunity to testify today. I look forward to any questions that you may have.